Pareto
Asset Management

Responsible investments

Report 2-2023

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"You can't improve what you don't measure."

Introduction

Finn Øystein Bergh
Chief Economist & Strategist

In our line of business, we have been busy adapting to new sustainability legislation, such as the EU Taxonomy and the Sustainable Finance Disclosure Regulation (SFDR). You may have seen a line or two about that in these responsible investment reports.

Henceforth, however, the burden of reporting will fall on our portfolio companies. There is a wealth of new legislation soon to enter into force, requiring substantially more reporting efforts. While some companies may experience this as an added layer of red tape, I'm inclined to state that it is red tape with a mission. A couple of quotes attributed to the late management guru Peter Drucker sums it up nicely:

"You can't improve what you don't measure"

And:

"What gets measured gets managed"

The idea is that the very job of producing and disclosing these numbers will spur companies to improve their performance along the reported dimensions. The insight embedded in these quotes has been confirmed time and again – and will be this time, too, I suspect.

Here's a brief overview:

The Corporate Sustainability Reporting Directive (CSRD) pushes beyond the boundaries set by its predecessor, the **Non-Financial Reporting Directive (NFRD).** It will expand the scope and depth of disclosures requested in other sustainability legislation. Companies falling within its purview will be required to report on a broader range of sustainability issues, including environmental, social, and governance factors.

The directive will enter into force in EU from 1 January 2024 and is expected to be adopted with effect from the same date in Norway. Larger corporations will be affected first, with successively smaller companies included all the way to 2028.

The European Sustainability Reporting Standards (ESRS) addresses the environmental, social and governance dimensions of business activities, introducing a targeted reporting framework. It underscores the significance of measuring and disclosing the impact of business operations on the environment and society. By focusing on these specific aspects, the directive aims to enhance the clarity and relevance of ESG reporting. It applies to all companies subject to the CSRD and has the same timeline.

The Corporate Sustainability Due Diligence Directive (CSDDD) introduces due diligence obligations, requiring companies to identify, prevent, and address the adverse human rights and environmental impacts associated with their operations and supply

chains. This directive adds a layer of depth to ESG reporting, emphasising the proactive identification and mitigation of risks.

It is not that different from **the Norwegian Transparency Act (Åpenhetsloven)** but includes environmental factors in addition to human rights and labour conditions. It is expected to enter into force in the EU in the spring, whereas Norwegian adoption remains to be seen.

You're excused if you don't immediately spot the difference between these various sets of legislation. The point here is simply that a lot more information – both more precise and more relevant – will be produced and reported by companies in the EU. Inasmuch as this is aligned with the reporting requirements and needs of institutional investors, it is likely to induce similar reporting from US companies seeking to attract European investors.

As for Pareto Asset Management, we applaud this development. For us, working to gain a better understanding of existing and prospective portfolio companies, more extensive and more precise company reporting will make our job easier.

It also provides an added advantage for active asset managers. With better access to a more extensive set of relevant data, we have even more information to help us select the right companies. The information thus produced is of no relevance to investors tracking the usual market cap-weighted indices. For us, it might just be exactly what we need to make the right choices for our investors and unitholders.

Analysing emissions: The Ørsted case

Nawel Boukedroun
Responsible ESG & Sustainable Investments

To gain a realistic understanding of carbon risk and make projections about portfolio decarbonisation and Paris Agreement alignment, the analysis must be approached with some pragmatism. Navigating this complexity involves a coherent use of resources and methodology.

Here is a case illustrating how we can go about this task. It involves the Danish company Ørsted, in which Pareto ESG Global Corporate Bond owns bonds.

Ørsted is a leading company developing and operating offshore wind farms, solar farms, energy storage facilities and bioenergy plants.

Ørsted is the largest energy company in Denmark. The company was renamed Ørsted from DONG (Danish Oil and Natural Gas) energy in 2017 after selling its upstream oil and gas production and becoming a renewable energy company.

Quality and reliability check

First and foremost, we need to get a good understanding of the data and its quality. This involves examining the sources of carbon emissions within a company, thereby identifying areas with the greatest potential but also coherence in setting reduction targets. In the case of Ørsted, 20% of the emissions come from scope 1&2, while 80% derive from scope 3.

For a long time, the primary focus was on analysing emissions and progress in scope 1 and 2 emissions, but we have observed a significant shift towards understanding and addressing the complexities of scope 3 emissions.

This presents a challenge due to a wider range of categories, some not directly controlled by companies themselves but by different stakeholders in the value chain.

Scope 3 emissions are a critical part of understanding company and portfolio level carbon risks – as they generally account for most companies' emissions.

The scope 3 emissions include the 15 sub-categories:

1. Purchased goods and services
2. Capital goods
3. Fuel- and energy-related activities (not included in Scope 1 or 2)
4. Upstream transportation and distribution
5. Waste generated in operations
6. Business travel
7. Employee commuting
8. Upstream leased assets
9. Downstream transportation and distribution
10. Processing of sold products
11. Use of sold products
12. End-of-life treatment of sold products
13. Downstream leased assets
14. Franchises
15. Investments

Ensuring companies report complete data across all three scopes is crucial to better anticipate carbon footprint reduction and avoid potential errors stemming from future coverage gaps. For instance, Ørsted has reported on scope 1&2 and all categories of the scope 3 except for subcategories 8, 10, 12, and 15, as these are not pertinent to the company's operations, which inherently have no emissions in these subcategories. All their data and disclosure are reviewed by an independent auditor.

Furthermore, Ørsted has consistently achieved an A rating, the highest possible score, from CDP's "Climate Disclosure Plan" for four consecutive years. These elements foster trust in data reliability, enabling us to proceed and analyse the company's climate action plan.

Decarbonisation trajectory

As a second step, we gather decarbonisations plans and targets of the companies we invest in, along with substantial details and a clear roadmap outlining their approach to achieving their goals. Acknowledging that we are not carbon experts and certainly do not have the competence to determine the timeline and the % of reduction needed for our companies, we highly value targets that have received validation from reputable organisations. Currently, the "SBTi" (Science-Based Targets Initiative) stands out as the most robust standard in this regard.

For instance, Ørsted has a SBT validated:

Short to mid-term:

- Reduce emissions by 98% by 2025 on scope 1 & 2 (2006 baseline)
- Reduce emissions by 50% by 2032 on scope 3 (2018 baseline)

Long term:

- Net zero on all the three scopes by 2040

Ørsted has implemented a robust plan to decarbonise operations, primarily focusing on offshore wind energy and biomass as key renewable energy sources, but also sustainable procurement practices. The latter entail evaluating and tracking suppliers on their sustainable practices, which directly influences scope 3 emissions.

EU Taxonomy, a good indicator

Company disclosures on the EU Taxonomy can also serve as a valuable indicator. The following graph demonstrates the progress of the

What are scope 1, 2 & 3?

The three scopes categorise the different types of greenhouse gas emissions created by a company, its suppliers and its customers.

SCOPE 1

Direct emissions from owned or controlled sources

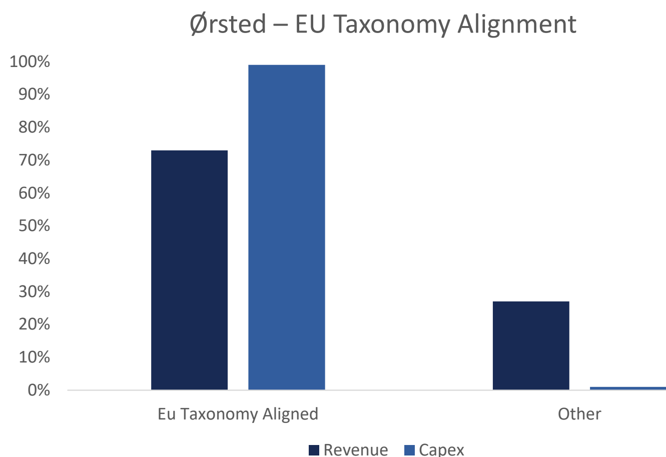
SCOPE 2

Indirect emissions from purchased energy by the company

SCOPE 3

Emissions that are a consequence of activities that are not owned or controlled by the company

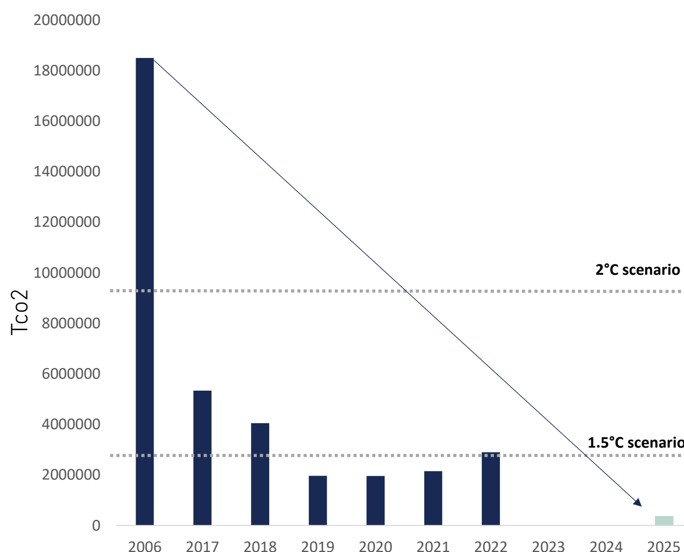
company with their environmentally sustainable pathway through the revenue stream derived from activities aligned with the EU Taxonomy. Additionally, it highlights the company's strategic commitment to sustainability by showcasing continued investments in greener solutions, as evidenced by the alignment of their capital expenditures with the EU Taxonomy.



Having taken those initial steps, we have gained confidence in the company's objectives and the reliability of the components involved.

Practice what you preach
The focus is now to observe the progress of companies in their carbon reduction efforts, as we delve into historical data to determine if the company is on a positive trajectory.

Ørsted carbon reduction progress on scope 1&2
Ørsted has an ambition of reducing these emissions by 98% by the end of 2025, using 2006 as a starting point.



Source: Ørsted, CDP and Pareto Asset Management. Scenarios are calculated according to the Intergovernmental Panel on Climate Change (IPCC) Special Report on 1.5°C scenario database

This stage of the analysis reveals both progress and potential delays in meeting their targets.

In the case of Ørsted, we note an increase of emission cuts due to the postponement to June 2024 for the shutting down of coal-based fired plants. This delay resulted from a combination of post-corona effects, including a shortage of wood pellets needed for the biomass-based plant, and the conflict in Ukraine. The Danish state, a major shareholder, required the company to keep supplying energy. Despite this, we observe that

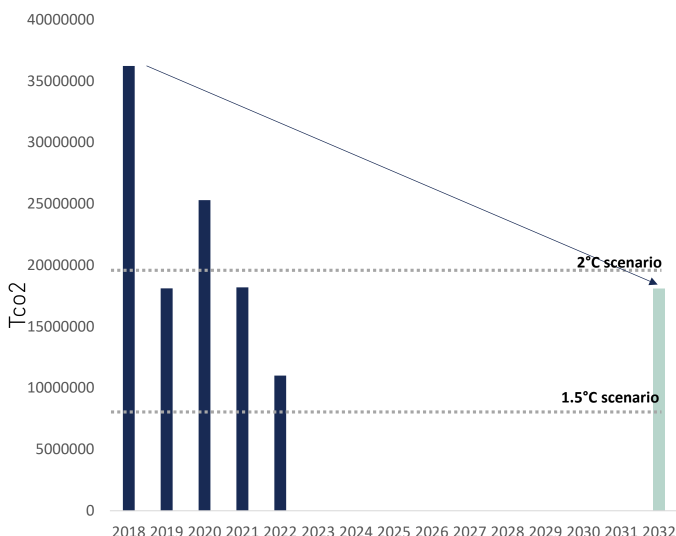
The EU taxonomy

The EU taxonomy for sustainable activities is a classification system that defines criteria for economic activities that are aligned with a net zero trajectory by 2050 and the broader environmental goals other than climate. The taxonomy was established to clarify which economic activities are environmentally sustainable, in the context of the European Green Deal. The aim of the taxonomy is to prevent greenwashing and to help investors make informed sustainable investment decisions.

the company remains on track and aligned with the Paris Agreement.

Ørsted – carbon reduction progress on scope 3

Ørsted has a goal of reducing these emissions by 50% by 2032 on scope 3 (2018 baseline).



Source: Source: Ørsted, CDP and Pareto Asset Management. Scenarios are calculated according to the Intergovernmental Panel on Climate Change (IPCC) Special Report on 1.5°C scenario database.

Here, we observe that in 2022, the company went beyond this objective. However, this is typically a case where it is important to understand the overall picture and be cautious in drawing overly optimistic conclusions. In this case, the achievement can be attributed to a halt in natural gas wholesale deliveries from a contractor. The company anticipates emissions to return to regular levels once they reopen one of their natural gas field but expect to remain on track to reach their 2032 target.

In order to project carbon reduction objectives within our funds, we need similar levels of transparency, commitment, reliability in disclosure and objectives from all our portfolio companies. While all firms are not there yet, upcoming regulations may enforce these standards. In the meantime, we will continue to encourage companies to reach or uphold this level of transparency and reliability.

Carbon intensity: The law of the few

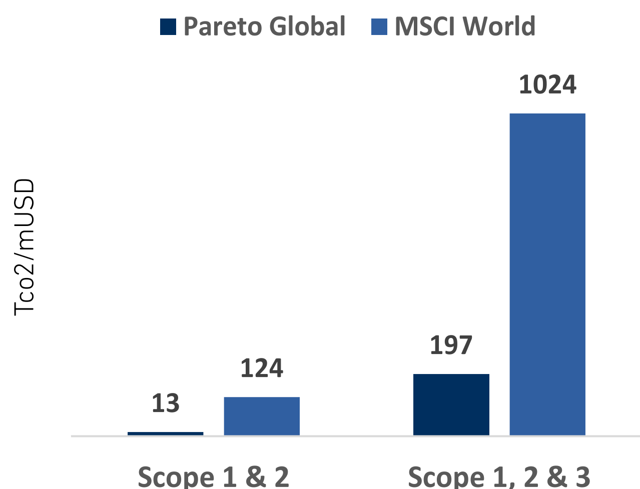
If you have been approached by asset managers concerned about the sustainability of their investments, you will have seen figures documenting their low carbon intensity relative to some index or perhaps selected peers. That goes for Pareto Asset Management as well.

Comparing our global stock fund Pareto Global with the MSCI World Index, we are likely to point out that the fund's carbon intensity is less than 20% of that of the index.

There – I've said it. Now, forget it. It's just a useful angle for studying why this difference arises. Most likely I could have used competing funds, but of course I won't.

Carbon intensity is typically measured as tonnes of emission divided by revenues (tCO2e/mUSD). Using 2021 figures from Sustainalytics, we find emissions of 197 tonnes per million us dollars in the fund, as against 1,024 tonnes for the index. These figures include both scope 1 (the companies' own operations), scope 2 (sourced energy), and scope 3 (up and down the value chain).

A first observation is that most of these emissions fall within the scope 3 channel. For the fund, scope 3 represents 93% of all emissions, and for the index the corresponding figure is 88%.

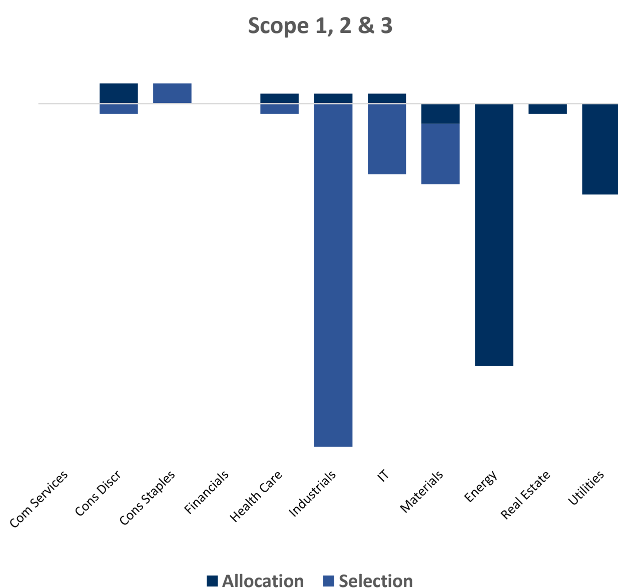


Source: Sustainalytics, Pareto Asset Management

A further point is finding out why there is such a large difference between the fund and the index. On closer inspection, most of this is down to five sectors: industrials, IT, materials, energy and utilities.

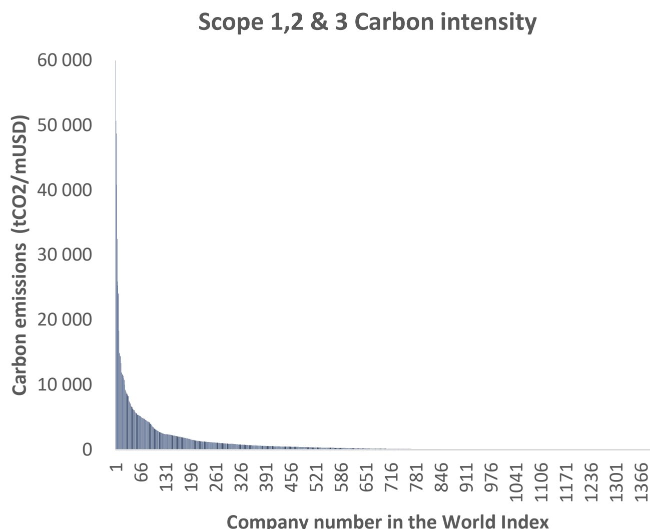
Part of the explanation, then, is investment policy. Pareto Global, seeking to avoid capital-intensive industries, will not invest in energy, real estate or utilities. Avoidance of these industries explains close to half of the carbon intensity reduction relative to the index (blue columns in the graph below). Policy matters.

In addition, stock selection explains a large part of the difference through lower emitting companies in, especially, industrials. Large conglomerates like General Electric and Emerson Electric are also large emitters, but they are not part of the fund portfolio. Similarly, the fund has no investments in semiconductor producers, nor mining or metallurgy – all of which are high-emitting sectors.



Source: Sustainalytics, Pareto Asset Management

«The law of the few»
Diving deeper into the index figures, we see that a surprisingly small number of companies are responsible for a large part of the total emissions. The following graph, based on individual company emissions in the Sustainalytics database (not weighted), makes the point visually. It does not even include the company with the highest carbon intensity, Wolfspeed, as this company would blow the scale completely – with emissions of more than 375,000 tonnes per million US dollars. Next on the list is Ingersoll Rand, at 61,500 tonnes per million US dollar.



Source: Sustainalytics, Pareto Asset Management

Further down the list, emissions fall abruptly. Number 27 emits less than 10,000 tonnes, whereas number 279 is below 1,000 tonnes. As of 2021, the Sustainalytics world index database covered 1,441 companies. In other words, less than 2% had emissions above 10,000 tonnes; less than 5% emitted more than 5,000 tonnes; and less than 20% were above 1,000 tonnes per million US dollars.

Weighted carbon intensity
While a small number of stocks register as high carbon intensity companies, even fewer companies are behind the bulk of the carbon intensity in the index. This is due to the low weight of some high emitters.

Here, four sectors stand out: materials, energy, industrials and utilities. And emissions within these groups are made by a very small minority. Summing up, we see that a very small share of the index universe represents most of the carbon emissions. For active asset managers wanting to limit their carbon intensity, a lot can be done with fairly limited deviations from the index.

You will, however, have to make conscious decisions on what industries and companies to select. And if you wish to reduce your carbon intensity by as much as 80%, I dare say you have to be an active manager. For Pareto Global, both the investment philosophy and the nitty gritty of fund selection contribute to this result. The same can probably be said of a lot of other actively managed funds – but not of truly passive management.

Guidelines for responsible investments

1. BACKGROUND AND PURPOSE

Pareto Asset Management AS ("Pareto Asset Management") aims at contributing to sustainable development of markets and long-term value creation by investing in a responsible and ethical manner. We believe that responsible investments are important for achieving the best possible risk-adjusted return for our unitholders and customers. Sustainability and sound corporate governance give companies competitive advantages and contribute to long-term value creation.

This document sets out guidelines for responsible investments undertaken by Pareto Asset Management on behalf of our unitholders and individual asset owners. The purpose of the policy is to prevent Pareto Asset Management from contributing to the violation of human rights, labour rights, corruption, environmental damage or other unethical actions. Furthermore, we consider it important to integrate sustainability assessments into our investment processes, as this can also affect the long-term value of our investment.

We expect the companies that we invest in to comply with the same principles.

As part of our efforts to promote responsible investments, Pareto Asset Management has signed the UN Principles for Responsible Investment ("UN PRI"). These guidelines are based on UN PRI, the UN Global Compact , the guidelines for the Norwegian Government Pension Fund Global, the Principles for the exercise of ownership rights in investment companies from the Norwegian Fund and Asset Management Association, as well as internationally recognised principles and conventions.

Please note that the fund Pareto Total solely is subject to the exclusion criteria as provided in section 2.2 and not the guidelines in their entirety.

2. RESPONSIBLE INVESTMENTS

2.1 Priorities

We seek to invest in companies that have good quality of operations and management. The companies should have a clear focus on ethical issues in their attitudes and actions, as well as having a value base for the business that complies with the guidelines. The companies must exert good corporate governance, comply with national legislation as well as international conventions, and show an open and complementary information policy. This means we emphasise social conditions, the environment, sustainability and good corporate governance when considering a company.

Ethical risk assessments must be conducted before an investment can be made.

2.2 Exclusion of companies

Pareto Asset Management shall not be invested, on behalf of our funds and customers, in companies which themselves or through entities they control:

- Produce weapons that, in normal use, violate basic humanitarian principles
- Produce tobacco
- Sell weapons or military equipment to states subject to sanctions from the UN Security Council or other international measures directed at a particular country that Norway has supported (mandate for the management of the SPU section 3-1 second paragraph letter c)
- Mining companies and power producers that themselves or consolidated with controlled entities receive 30 percent or more of their revenues from thermal coal, or base 30 percent or more of their operations on thermal coal activity
- Produce pornography

Pareto Asset Management may decide to exclude a company if there is an unacceptable risk that the company contributes or is responsible for:

- Human rights violations, such as killing, torture, deprivation of liberty, forced labour and exploitation of children, including child labour
- Violations of individuals' rights in war or conflict situations
- Breach of basic employee rights
- Severe environmental damage
- Actions or omissions that at an aggregated company level lead to an unacceptable degree of greenhouse gas emissions Corruption
- Other repeated or significant violations of basic ethical norms

Pareto Asset Management shall exercise a

[1] The contents of UNPRI can be found here: www.unpri.org/pri/an-introduction-to-responsible-investment.

[2] The UN Global Compact contains ten general principles derived from the Universal Declaration of Human Rights, the ILO Declaration of Fundamental Principles and Rights in Work and the Rio Declaration on Environment and Development.

[3] This includes "the worst forms of child labour" as defined in the ILO Convention (No. 182) Article 3.

precautionary principle in connection with investments in biotechnology companies, weapons, gambling and alcohol.

3. CORPORATE GOVERNANCE

Pareto Asset Management shall exercise active ownership in the portfolio companies in order to promote responsible business operations. This means that we will use our ownership rights and influence in the companies to help move the companies in a positive direction in terms of social relations, environmental issues, sustainability and good corporate governance.

When there is a specific reason to believe that a company violates our policy of responsible investments, we will consider addressing the issue with the company's management and encouraging the company to correct the circumstances. If necessary change is not implemented, Pareto Asset Management will normally sell all positions in the company.

4. RESPONSIBILITY FOR MONITORING AND CHECKING THE GUIDELINES

Pareto Asset Management has established an ethics committee entrusted with the responsibility to ensure that the company's guidelines for responsible investments are up to date and appropriate, as well as assess and decide exclusion of companies in accordance with paragraph 2.3 of the guidelines. It will also assist portfolio managers with training, advice and sparring as needed. In particularly demanding cases, the Ethics Committee shall inform the CEO.

The Ethics Committee is headed by the company's Chief Economist & Strategist and consists, in addition, of representatives of different departments as required.

Twice a year, the Ethics Committee prepares a report on our guidelines for responsible investments and the practice of these. The report reviews specific topics we have worked with as well as relevant company assessments and dilemmas. It shall be available to our customers.
The chairman of the Ethics Committee shall annually provide the Board of Pareto Asset Management with an overview of the status of ongoing work for responsible investments in the company.

The Compliance Manager shall supervise compliance with our Guidelines for Responsible Investments, including the necessary exclusion of companies. In addition, the compliance officer will attend meetings of the Ethics Committee as an observer.

The UNPRI principles

Behind the UNPRI principles is the UN Environment Program Finance Initiative (UNEP FI). UNEP FI is a global partner-ship between the United Nations Environment Program and the financial sector. Among the goals for the collaboration is to identify, promote and realize best environmental and sustainability practices in the financial industry. Central to this collaboration are ESG questions, derived from the English concepts environmental issues, social issues and corporate governance.

Through our signature, we committed ourselves to respond to ESG questions that may follow, to the best of both our customers in the long run and for society as a whole:

1. We will implement ESG issues in our investment analysis and decision-making processes
2. We will practice active ownership and implement ESG in our ownership policy and its exercise
3. We will work for satisfactory reporting on ESG topics from our portfolio companies
4. We will promote acceptance and implementation of the principles in the financial industry
5. We will work with other signatories to strengthen the effect of the principles and their implementation
6. We will report on our activities and our progress in implementing the principles

Our signature also includes a more general, implicit obligation to follow principles and standards anchored in the UN. These are voluntary, non-judicial recommendations that express expectations of good corporate governance, and which provide expectations for good corporate practices in dealing with environmental and social issues. In assessing our investments, these principles and standards will act as a reference framework and guide.

The UN Global Compact contains ten general principles derived from the Universal Declaration of Human Rights, the ILO Declaration of Fundamental Principles and Rights in Work and the Rio Declaration on Environment and Dvelopment. The principles are general and state, among other things, that companies must respect human rights and not be involved in violations of them, maintain freedom of association and collective bargaining rights, and eliminate all forms of forced labor, child labor and discrimination in working life.

Investing in a responsible and ethical manner

Pareto Asset Management aims at contributing to sustainable development of markets and long-term value creation by investing in a responsible and ethical manner.

We believe that responsible investments are important for achieving the best possible risk-adjusted return for our unitholders and clients. Sustainability and sound corporate governance give companies competitive advantages and contribute to long-term value creation.

As part of our efforts to promote responsible investments, Pareto Asset Management has signed the UN Principles for Responsible Investment (PRI). These guidelines are based on UN PRI, the UN Global Compact, the guidelines for the Norwegian Government Pension Fund Global, the Principles for the exercise of ownership rights in investment companies from the Norwegian Fund and Asset Management Association, as well as internationally recognised principles and conventions.

Pareto Asset Management shall exercise active ownership in the portfolio companies in order to promote responsible business operations. This means that we will use our ownership rights and influence in the companies to help move the companies in a positive direction in terms of social relations, environmental issues, sustainability and good corporate governance.

Our product-based exclusion criteria

Weapons and ammunition

A variety of types of weapons, ammunition and warfare methods are prohibited under international law, such as the Geneva Convention. In addition, Pareto Asset Management may exclude companies involved in weapons production as a precautionary principle.

Tobacco

Tobacco is a legal stimulant, which according to WHO is causing several million deaths in the world each year.

Coal

Pareto Asset Management follows the Norwegian Government Pension Fund in its assessment of coal producing companies.

Pornography

Pareto Asset Management does not invest in companies producing pornography.

Our product-based precautionary principles

Biotechnology

Modern biotechnology touches life's big questions and has an impact on what we think about human worth. It is therefore relevant to the whole global population, and not just doctors and researchers who carry out in vitro fertilisation, map genes and research stem cells. Investments in biotechnology may involve a risk of violation of fundamental ethical norms.

Alcohol

We have considered whether there should also be an absolute ban on investments in alcohol but has concluded that it is neither desirable nor manageable in an ethically consistent and sound manner.

Alcohol as a food additive is generally considered to have many positive aspects. Furthermore, alcoholic beverages are embedded in most societies, with many businesses indirectly profiting from alcohol consumption. Breweries, wineries and distilleries stand out as obvious examples, but also wholesalers, hotels, restaurants, airlines, shipping companies, railways and especially grocery chains may have a significant portion of their profits from the sale or delivery of alcohol. The same applies, of course, to real estate companies with revenue-based rent, such as the listed company Olav Thon Eiendomsselskap (OSE).

An absolute ban on investments in companies with interests in alcohol will therefore likely be perceived as a case of double standards, and insurmountably complicated. In consideration of the significant social and health problems relating to alcohol abuse, the company will nevertheless apply a precautionary principle with investments in alcohol.

Gambling

We have considered whether there should be a ban on investments in gambling. At this point, our assessment is that a general ban is problematic for several reasons.

Gambling has a relatively wide definition, covering everything from games that primarily fills an entertainment function, to more economically active activities where the outcome is largely due to chance and luck.

For the purpose of these guidelines, it's the possible harmful effects that are of importance. The consequences of gambling can be summarised in two words: gambling addiction.

Pareto Asset Management does not want to act in a way that contributes to increasing and more harmful gambling addiction. As part of the investment process we must therefore always raise the question of whether the company in question operates in such a way that it is likely to create gambling addiction.

In our opinion, a general ban will not contribute to better achievement. An important element is that a significant part of the gambling business largely, or wholly, fills an entertainment function. Although the gains are in the form of money, unlike the teddy bear in the amusement park, the stakes are normally such that participation is for fun, excitement and surprise, not because it nourishes some presumption of getting rich.

Furthermore, gambling, like alcohol, has such an extent that it can be difficult to draw sharp limits. One might imagine a kiosk chain with deployed slot machines of a type approved by the relevant authority, where the kiosks get a lease while the profits are due to a third party. The chain then has no benefit of increased gaming on the vending machines, and their own activity can be claimed to be limited to the letting of floor space.

Similarly, gambling is offered on most cruise ships and passenger ferries, as well as at some hotels. In addition, there are companies producing the game machines used without this being considered gambling. For these reasons, we have concluded that there should be no general ban on gambling. On the other hand, it seems obvious that we should apply a precautionary principle when investing in companies that offer gambling.

Conduct etc.

Human rights violations

Gross or systematic violations of human rights such as killing, torture, deprivation of liberty, forced labour, the worst forms of child labour. In our reviews, we have not found any circumstances that indicate that any of our portfolio companies contribute to such human rights violations.

Serious environmental damage

Serious environmental damages can be said to include severe climate impact in the form of relatively high greenhouse gas emissions, which is also in line with Norway's international commitments and the government's climate report.

Based on this review, we are not aware of circumstances that indicate that any of our portfolio companies contribute to serious environmental damage. However, we have previously spent a lot of time assessing the situation for **Norsk Hydro**'s operations in Brazil, where heavy rain in February 2018 led to flooding and environmental damage. The company is no longer on our watch list.

Greenhouse gas emissions

The section on climate risk goes into further detail on our assessments in this area. Suffice it to say that we have no company-wide, principled objections to fossil fuel as such, but we do care that the companies in question work to limit emissions and other side effects of their business. Two of our funds have a stated policy of not investing in fossil fuels.

Gross corruption

It goes without saying that corruption is unacceptable to a responsible investor. The problem is generally one of discovery, which seldom takes place without criminal investigation and proceedings. Our challenge then is to evaluate the quality of governance going forward.

We have had instances of corruption also in partly government-owned companies in Norway. As a general rule, we don't necessarily sell our holdings simply because something unacceptable has happened. We will have to evaluate the risk of the problem repeating itself, whether it was a singular case or a consequence of a permeating problem, and of course what is being done in order to get their house in order.

Other particularly gross violations of basic norms

We have not identified other gross violations of basic norms.

Corporate governance

Engagement policy

Pareto Asset Management conducts meetings with the management and board members in many of the portfolio companies, as well as shareholders, on a regular basis. This dialogue is the most important instrument we use in our work as an active owner.

Grounds for initiating engagement activities may be breach of ESG criteria, substantial investment in the company or a need for more information on critical ESG damage that has already occurred.

Requests from clients can also be grounds for engagement.

Proxy voting

Pareto Asset Management has established its own voting guidelines. These are based on the Norwegian Code of Practice for Corporate Governance.

Please note that we don't vote just for the sake of voting. We see no point in casting the maximum number of votes. Most agenda items are standard, plain vanilla issues. Some may be of greater importance. In some of these cases, the outcome is far from given. If we feel that a certain outcome is important, we will contribute to attaining that outcome by voting.

However, casting votes has a cost. In some cases, more specifically with some global companies, it may be inordinately cumbersome. In that case, casting a vote may not be in the best interest of our investors or unitholders.

After all, that is our guiding light: We do what's in the best interest of our clients and unitholders.

Active ownership

Stating the obvious, our portfolio companies are not perfect. If we decide to invest in a company, there is most often a lot we wouldn't mind being able to change. That leaves us two options.

There is a phrase called "voting with your feet", which means leaving something or someone you disagree with, rather than trying to change them. In our industry, we might say that we vote with our wallets. We do this when we sell something we do not want to own – or, conversely, seek particularly promising investments.

But we do more than that. We also try to influence the companies we own. We vote at annual general assemblies, we have direct dialogue with management or try to work with other committed shareholders. And we do believe that, sometimes, we can push the development in the desired direction.

Our Norwegian equity portfolios consist of companies we know well, in many cases after years of ownership and a number of opportunities for dialogue with management. In the fund Pareto Aksje Norge, which has a relatively low turnover rate, we have engaged in dialogue with practically all the companies in the portfolio on corporate governance, environment and (to a lesser extent) social conditions over the past few years. These are companies we know well, with direct lines to top management.

We also have discretionary management of Norwegian equities. These mandates all hold the same companies as Pareto Aksje Norge, which simplifies engagement. The combined portfolio is our largest in the equities space, representing the major part of our Norwegian stock investments.

These are some of the topics that our portfolio managers have raised in discussions with portfolio companies in the past year:

Multiconsult: Discussions with the board of directors and the largest owner (Multiconsult foundation) on how the management incentive scheme is designed to align interests.

Lumi Gruppen: Discussions regarding listing on the main Euronext list and aligning reporting to comply with the NUES guidelines. Discussions with management regarding how employees are treated during the downsizing of physical schools (layoffs).

Akva Group: Discussions regarding the new strategic owner (Israel Corporation, 18%) and reporting quality of both financial and non-financial information.

Veidekke: Environmental ambitions for the asphalt business and degree of recycling of cement in new projects. Discussions on capital structure and capital allocation.

Elkem: Governance aspects of Chinese-based Bluestar being the majority shareholder. Employee rights and environmental targets set by the company.

Borregaard: Discussions on emission -targets and pathway to reach the targets.

Odfjell: Management incentive programme and aligning interests with shareholders to a larger extent.

TGS: Dialogue on the management compensation scheme.
Given our relative size in the Norwegian stock market and the long-standing relations with most of our portfolio companies, we do believe that our views hold some weight and provide useful input to these companies about investor concerns. In addition, such dialogues produce important information about key risk factors in the companies in which we have part ownership.

We have, however, concluded that we are not going to vote just for the sake of voting. While some asset managers make a point of their having voted at so and so many general assemblies, we will prioritise issues where the outcome is of significance and importance to our unitholders. This enables tighter control with the exercising of voting rights, which ultimately rests with the Board of directors. And, in many instances, the resources can be better spent on materially relevant issues – e.g. through discussions with company management.

Of course, many of our foreign positions are in significantly larger companies with a somewhat longer

distance to top management. It's not likely to be easy to get in personal contact with the management of Microsoft or Alphabet, which owns Google. But we have the same digital presence as all other investors, our input is recorded at one level or another, and we get the same information as everyone else.

As for bond funds, active ownership takes on a different meaning. Per definition, we have no voting rights with these funds. However, we have observed that it is generally easier for fixed income investors to reach companies seeking for capital on the debt market. Our bond issuers are often unlisted and can be out of the regulatory scope. This is the reason why we believe that fixed income fund managers have an important role to play in positively influencing bond issuers in the right direction. As responsible investors, we consider engagement activity a key component of active ownership.

Of course, influencing potential bond terms may also have financial benefits. Again, we see that there is no inherent contradiction between responsible investment and profitable investment. On the contrary, we keep getting confirmation that responsible investment also contributes to good risk-adjusted returns.

Company assessments

Rockwool – still cloudy on coal
The Danish company Rockwool is probably best known for rock wool for insulating houses, but also produces, among other things, facade panels and roof panel systems intended to reduce noise and fire hazards. Most are products that provide a factual basis for the company's unrelenting emphasis on sustainability and the circular economy. For example, rock wool makes a good contribution to reducing energy needs in homes and offices.

The problem is that the production of these products consumes a lot of energy. And Rockwool bases part of its production on coal. How much?

Well, that's information that the company will not divulge. – Due to the competitive nature of our industry, we do not disclose this information, the company replies. For Pareto Asset Management, this is a problem, as our policy does not allow companies that base 30 per cent or more of their business on thermal coal.

We have not taken the step of excluding the share, letting three arguments decide. Firstly, management is very clear that they are going to reduce the use of coal. There are ongoing, credible plans to shift to cleaner energy sources. In 2022, 31% of capital expenditures went towards sustainability, with a focus on sustainable energy. Total scope 1 & 2 emissions were cut by four per cent.

Secondly, the share is not on the exclusion list of the Norwegian Government Pension Fund Global, which has the same restriction on coal use.

And thirdly, the products are obviously sustainable. This is not just about focusing inquisitorially on the problems. Sustainability is about opportunities, and here they are good. Rockwool itself believes that the products they sold in 2021 and 2022 will save 100 times the energy consumed during their lifetime. We therefore think that Rockwool is a good company to own, which we do in the funds Pareto Nordic Equity and Pareto Nordic Omega.

We will still work to gain more insight into the company's energy use. This is also about the value that we place on transparency in the companies we own. At Rockwool it is a little too opaque.

This is not just about focusing inquisitorially on the problems. Sustainability is about opportunities.

Catalent – safety issues
US company Catalent is a global provider of delivery technologies, development, drug manufacturing, biologics, gene therapies and consumer health products. Earlier this year, Pareto ESG Global Corporate Bond owned bonds in the company.

In April, Catalent flagged productivity issues and announced a profit warning following a slower-than-expected ramp up in production capacity. After further analysis, it was found that the slowdown was due to a third-party investigation on safety management in one of the factories.

For this reason, the fund management team decided to sell their position. In their opinion, the company was no longer in line with their expectations of good governance practices, but they will keep an eye on the company to see if the necessary progress is made.

Danske Bank – finishing the cleanup in 2023

In May 2018, the Danish FSA announced that it would impose fines on Danske Bank as a penalty for several years of money laundering in Estonia. The culpable department was shut down in 2015, the bank was conducting an audit of its Estonian branch, and we thus figured that we invested in a bank fully engaged in clean-up and self- questioning.

The bank submitted its internal review in September

2018, revealing much more comprehensive money laundering than we had assumed. Worse yet, the report exposed a pervasive culture of unacceptable attitudes in the bank, in the sense that top management and the Board should have acted several years ago. For a long time, the bank trusted the reporting from the Estonian branch and the group's overall money laundering routines. The reporting later turned out to have been deficient and misleading, and group routines failed.

The first internal whistleblowing came late in 2013. It put the case on the agenda for both group management and the Board. Measures taken in 2014 proved to be insufficient. Towards the end of 2014, there came a highly critical report from the Estonian supervisory authority, and the business was finally shut down in 2015.

In later years, the bank has hired many people in compliance and IT services to prevent money laundering. A lot has been invested in IT systems related to this. All of the bank's employees have undergone training to both prevent money laundering and correct errors in a proper manner. In addition, the Board has appointed a separate sub- committee for Conduct & Compliance. Danske Bank claims it is 90% complete with the financial crime prevention setup, as part of the "Better Bank strategy", and will complete the plan by 31 December 2023. We consider it far less likely that the next banking sector issue will originate from Danske Bank.

In December 2022, final coordinated resolutions were reached with the US Department of Justice, the US Securities and Exchange Commission and the Danish Special Crime Unit. The bank fully accepted the findings and apologised unreservedly for the unacceptable historical failings and misconduct. The investigations resulted in a total settlement of DKK 15.3 billion, covered by earlier provisions. All amounts have been paid in January 2023.

Danske Bank remains subject to a criminal investigation by authorities in France and the bank states that it continues to cooperate with the authorities. Danske Bank is also subject to ongoing litigation in relation to the Estonia matter. The bank will continue to defend itself against these civil claims.

Pareto Nordic Corporate Bond, Pareto Likviditet and Pareto Obligasjon hold bonds in the company.

Previous mentions

Wells Fargo – remains of a culture problem?
In 2016, it was revealed that bank accounts in Wells Fargo were created without the approval of the clients. The audit firm PwC was engaged by Wells Fargo to uncover the scope. Their review documented that this involved up to 3.5 million deposit accounts and 565,000 credit card accounts. It was further revealed that this had been going on from 2011 to the end of 2015. The review pointed all the way to top management.

For a more detailed walk-through of the issue, please see previous RI reports.
Even as these sales practices are history and the company has made a complete revamp of senior management and more than 80 per cent of the board, the US Federal Reserve has not lifted the asset cap it imposed, limiting the bank's balance sheet to just under $2 trillion. Timing of the removal is still uncertain, but there have been several positive signals that this process is moving forward. Closing the gap towards US Federal Reserve requirements is an ongoing process, but the time frame remains uncertain.

We believe that this process has been constructive for Wells Fargo. Major changes have been made in the management of the company and, we believe, its culture. Furthermore, all else being equal, the asset cap has probably been productive in elevating the quality of Wells Fargo's balance sheet at a time when the economy was running at full capacity.

Pareto Total sold their shares in Wells Fargo in November 2023.

Stora Enso and UPM Kymmene – cartel investigation closed
Pareto Nordic Equity and Pareto Nordic Omega own shares in Stora Enso. The company announced in October 20201 that it was included in the European Commission's inspection of the wood pulp sector and subject to inspections at its premises.

In June 2023, the European Commission announced that after a thorough and careful assessment, it has decided to close its investigation.

The same goes for UPM, where PNO no longer has any short position.

We have no independent basis for suspecting anything illegal and have not changed our positions in the two companies.

Common acronyms in ESG investment and regulations

The emergence of ESG investing and related regulations has spawned a myriad new acronyms. If you don't work in this field, you probably don't know all of them.
Here is a short overview that may come in handy:

- **CDP:** CDP (the Carbon Disclosure Project) is a non-governmental organization (NGO) that runs a global disclosure system to manage the environmental impact for private and public institutions. Nearly 10,000 of companies, cities, and governmental institutions report on their risks and opportunities related to climate change.

- **CSRD:** The Corporate Sustainability Reporting Directive. In order to help the financial industry to better assess company extra-financial aspects, the EU Commission requires large public-interest companies with more than 500 employees to report information on how they manage environmental, social and governance issues in their business operations. Companies that fall under the scope of CSRD will have to disclose EU Taxonomy-related information.

- **EU Taxonomy:** The EU Taxonomy regulation, which entered into force in the EU in January 2022, has established a classification system of environmentally sustainable activities that translates the EU's climate and environmental objectives into criteria or specific economic activities purposes. The EU Taxonomy recognizes 'environmentally sustainable' economic activities that make a substantial contribution to at least one of the EU's climate and environmental objectives:
  - Climate change mitigation
  - Climate change adaptation
  - The sustainable use and protection of water and marine resources
  - Transition to a circular economy
  - Pollution prevention and control
  - The protection and restoration of biodiversity and ecosystems

  In addition, the investment must respect the do no significant harm criteria and be in line with the minimum safeguard.

- **GHG:** Greenhouse gases (GHG) are gases that absorb and emit radiant energy within the thermal infrared range, causing the greenhouse effect. Greenhouse gases shall be calculated according to the GhG protocol or similar official standard.

- **GRI:** The Global Reporting Initiative publishes GRI Standards, which provide guidance on disclosure across environmental, social and economic factors for all stakeholders including investors. These standards are used by organizations worldwide.

- **PAI:** According to SFDR, Principal Adverse Impacts (PAI) are impacts of investment decisions or advice with material, negative effects on sustainability factors. Sustainability factors mean environmental, social and employee matters, respect for human rights, anti-corruption, and anti-bribery matters.

- **PRI:** Principles for Responsible Investment is an international network of investors/signatories working together with a common ambition to foster ESG ownership decisions in investment. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

- **RTS:** Regulatory Technical Standards are a set of technical compliance standards that, once endorsed by the European Commission, need to be met by all parties. Under the SFDR, RTS are the rules that financial market participants need to obey to comply with regulations.

- **SBTi:** The Science Based Targets initiative ("SBTi") is an alliance created between CDP, the United Nations Global Compact, the World Resources Institute (WRI) and the World Wide Fund for Nature (WWF). The initiative ensures that companies' net-zero targets are consistent, by assessing the robustness of climate action plan via science-based methodologies.

- **SDGs:** The Sustainable Development Goals ("SDGs") are 17 goals developed in global partnership to achieve the plan of actions for peoples, planet and prosperity as set out in the 2030 Agenda for Sustainable Development.

- **SFDR:** The Sustainable Finance Disclosure Regulation (SFDR), applied in the EU from March 2021, is a European regulation introduced to improve transparency in the market for sustainable investment products, to prevent greenwashing and to increase transparency around sustainability claims made by financial market participants. SFDR sets different kinds of disclosure requirements for three types of funds or other financial products within the scope of the regulation:

  - Article 6: Funds that do not integrate a sustainability focus into the investment process.
  - Article 8: Funds that promote environmental and or social characteristics, referred to as "Light Green" funds.
  - Article 9: Funds that have 'sustainable investment' as their objective, referred to as "Dark Green" funds.

- **TCFD:** Task force on Climate-related Financial Disclosures is a market-driven initiative developed to establish and recommend a general framework for identifying, assessing and reporting climate-related financial disclosures. TCFD focuses on four key areas: governance, strategy, risk management, and metrics and targets.

Pareto Asset Management AS

Dronning Mauds gate 3
0250 Oslo

Postbox 1810, Vika
NO-0123 Oslo

t: +47 22 87 87 00
e: post@paretoam.com

paretoam.com